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TO OLIVER WENDELL HOLMES, LL. B. '66, the Editors of the HARVARD LAW REVIEW dedicate this number, on the happy occasion of his eightieth birthday.

LETTERS OF CREDIT. — A buyer procures a bank to issue an irrevocable or confirmed letter of credit in favor of the seller.¹ Prior to, or subsequent to, or simultaneous with the issue of the letter by the bank the buyer and the seller enter into their contract for the sale of the goods. What relation does the sales contract bear to the letter of credit?

In order to determine upon what theory a special, irrevocable, commercial letter of credit² can be sustained as a binding obligation upon

¹ See YORK, FOREIGN EXCHANGE, 137; HOUGH, PRACTICAL EXPORTING, 464; Omer F. Hershey, "Letters of Credit," 32 HARV. L. REV. 1.

² Commercial letters of credit are of two types. The first type is the general letter which is addressed either to the world at large or to the person to whom the credit is to be given for the purpose of procuring a credit from some third person. Russell v. Wiggan, 2 Story (U. S.) 213 (1842); Lawrason v. Mason, 3 Cranch (U. S.) 492 (1806); Bissell v. Lewis, 4 Mich. 450 (1857). See STORY, BILLS OF EXCHANGE, 4 ed., § 462. The second type is the special letter which is addressed to the particular person who is to advance the money, or to give the credit, or to furnish the goods to a designated third person. Bank of Seneca v. First National Bank of Carthage, 105 Mo. App. 722, 78 S. W. 1092 (1904). The bank is sometimes spoken of as the issuer, the buyer as the holder, and the seller as the addressee. See Omer F. Hershey, "Letters of Credit," 32 HARV. L. REV. 1. The term "holder" is a misnomer. It originated at a time when general commercial letters were more usual than special letters. The term is also aptly used in connection with travelers' letters of credit. At the present time the special letter sent directly to the seller has almost entirely supplanted the general

the bank in favor of the seller four analyses may be considered.³ 1. The letter may be the notification of a contract made between the buyer and the bank for the benefit of the seller.⁴ It is, however, more in accord with the facts, as well as commercially more desirable, to regard the letter as a direct promise to the seller. 2. The letter may be a representation by the bank that it has received money, or the equivalent, to the use of the seller which it is estopped to deny after the seller has acted in reliance thereon.⁵ An estoppel, however, depends upon the facts of the particular case.⁶ The making of the sales contract can be the only action taken in reliance upon the letter, and frequently the sales contract is made prior to its issue. Moreover, the bank seldom receives funds in advance from the buyer. It is making a promise, not representing a fact. The essence of the transaction is a future credit. Nor is the seller misled, for the custom of business is as well known to him as it is to the bank and to the buyer.⁷ Hence, the elements of an estoppel are wanting. 3. The letter may be an offer from the bank to the seller which becomes a binding obligation upon acceptance by the seller in the terms of the offer.⁸ To this analysis there are three fundamental objections. The bank is not bargaining for the purchase or sale of goods. Consequently there is no consideration in fact. Furthermore, unless the sales contract is made subsequent to, or simultaneous with the issue of the letter, performance by the seller cannot amount to consideration in law. Moreover, the letter, if regarded as an offer, is an offer for a unilateral contract. Acceptance can only be the performance of the acts requested. Consequently, since the specified acts require time for

letter. Moreover, the term "holder" is confusing, because of its use in connection with negotiable instruments. It is better, it is submitted, to use the terms "buyer," "seller," and "bank."

³ It has been suggested that the most satisfactory doctrine would be that irrevocable letters of credit should require no consideration. See Omer F. Hershey, "Letters of Credit," 32 HARV. L. REV. 1. One objection is that these letters are not formal contracts. Another objection is that the common law requirement for consideration in simple contracts has become fundamental. Indeed, consideration is required for negotiable instruments. *Holliday v. Atkinson*, 5 B. & C. 501 (1826). To require no consideration, and to allow the issuing bank to set up no defence based upon the conduct of the buyer would furnish a simple rule. But this is more within the province of the legislature than of the courts.

⁴ *Carnegie v. Morrison*, 2 Metc. (Mass.) 381 (1841).

⁵ This is the view strongly advocated by Mr. Hershey. His principal authority is *Johannessen v. Munroe*, 158 N. Y. 641, 53 N. E. 535 (1899). The facts of the case do not support the learned writer. The case was argued on the theory that the consideration for the letter was furnished to the bank by the buyer. The facts also show a novation. The court, it is true, based its decision upon estoppel. But the estoppel arose, not because of the letter of credit, but because of certain oral representations made by the bank to the seller. The court particularly stressed the peculiarities of the facts. Mr. Hershey's combined doctrine of money had and received to the use of the seller and estoppel is based upon certain continental legal doctrines which are foreign to our law.

⁶ *Low v. Bouverie*, [1891] 3 Ch. 82.

⁷ See *Morgan v. Larivière*, L. R. 7 H. L. 423 (1875).

⁸ *Bank of Seneca v. First National Bank of Carthage*, *supra*; *Cheever v. Schall*, 87 Hun (N. Y.) 32 (1895); *Union Bank of Louisiana v. Coster*, 3 N. Y. 203 (1850); *Lawrason v. Mason*, *supra*. See 1 WILLISTON, CONTRACTS, § 32. The offer theory originated with travelers' letters and with general letters. It has been the orthodox theory applied indiscriminately to all letters of credit. Special letters differ in analysis from general letters, and the offer theory should be confined to the latter.

performance, and since the offeror can revoke the offer at any time before it has been accepted,⁹ the offer theory destroys the manifest intention of the parties that the letter of credit shall be irrevocable. 4. There is, however, a common-law analysis which is in accord with the facts, complies with the conception of the parties, and gives effect to their intention that the letter shall be a binding obligation from the moment of issue. What the parties have in mind is a bilateral contract between the buyer, the bank, and the seller with the consideration for the bank's promise to the seller moving from the buyer in the form of his promise to the bank to reimburse.¹⁰ Since the letter is a bilateral contract, as soon as it is issued the seller obtains executory rights against the bank. The acts which he is to perform are not the consideration for, but are conditions of the bank's promise. The last analysis which is here advanced seems to be the view of the best considered and most recent cases upon letters of credit.¹¹

It has recently been held that the sales contract is wholly independent of the letter of credit and that defences arising under the sales contract have no effect upon the obligation of the bank to the seller under the letter.¹² These cases must be taken as definitely abandoning the orthodox offer theory, and as adopting the analysis that a letter of credit is a direct promise to the seller supported by consideration moving to the bank from the buyer. The courts were, however, so intent upon supporting the validity of the letter that they overlooked the fact that in certain cases the sales contract would have a material relation. It should be possible both for the buyer and the bank to protect themselves. If performance of the sales contract in a specified manner is expressly made a condition of the letter the bank would be able to insist upon the condition; or if shipments and the drawing of drafts in a specified manner are expressly made conditions of the sales contract the buyer could take advantage of the conditions, not because he would be relying on an independent contract, but because he would be insisting upon his own.¹³

⁹ See 1 WILLISTON, CONTRACTS, §§ 60, 60b.

¹⁰ Upon principle there is no objection to this type of contract. See 1 WILLISTON, CONTRACTS, § 114. In England, however, it is doubtful, on the authorities, whether there can be a contract with the consideration moving from one other than the promisee. *Thomas v. Thomas*, 2 Q. B. 851 (1842); *Dunlop Pneumatic Tyre Co. v. Selfridge*, [1915] A. C. 847. But the latter case dealt with a contract for the benefit of a third person, and not with a contract where the consideration is furnished by one other than the promisee. It is submitted, therefore, that the question is still open in England, in spite of strong *dicta*. In the United States it is well settled that consideration moving from one other than the promisee is sufficient to support a promise made directly to the promisee. *Hamilton v. Hamilton*, 127 App. Div. 871, 112 N. Y. Supp. 10 (1908); *Palmer Savings Bank v. Insurance Company of North America*, 166 Mass. 189, 44 N. E. 211 (1896); *Rector of St. Mark's Church v. Teed*, 120 N. Y. 583, 24 N. E. 1014 (1890); *Bell v. Sappington*, 111 Ga. 391, 36 S. E. 780 (1900); *Williamson v. Yager*, 91 Ky. 282, 15 S. W. 660 (1891); *Schmucker v. Sibert*, 18 Kan. 104 (1877); *Van Eman v. Stanchfield*, 10 Minn. 255 (1865). See *Lawrence v. Fox*, 20 N. Y. 268 (1859).

¹¹ *Frey & Son v. Sherburne & Co.*, 184 N. Y. Supp. 661 (1920); *American Steel Co. v. Irving National Bank*, 266 Fed. 41 (1920); *Sovereign Bank of Canada v. Bellhouse, Dillon & Co.*, Q. R. 23 K. B. 413 (1911).

¹² *Frey & Son v. Sherburne & Co.* and the *National City Bank*, *supra*; *American Steel Co. v. Irving National Bank*, *supra*. See RECENT CASES, p. 560, *infra*.

¹³ The court admitted that the buyer would have an action at law against the seller for breach of contract. It is difficult to see why he should not have an injunction in

The elimination of the buyer-bank side of the triangle from the obligation of the bank to the seller is a more difficult problem. Should the bank be able to set up against the seller equitable defences arising because of the conduct of the buyer in procuring the letter? Since the very purpose of the letter of credit is to assure the seller, the bank should be precluded from doing so, unless the seller after receiving the letter has not changed his position. Upon the offer theory it is impossible to protect the seller. On the estoppel theory it is impossible to protect the bank. On the better analysis that the letter is a bilateral contract between the bank, the buyer, and the seller with the consideration furnished by the buyer for the bank's promise to the seller, it is possible in certain cases to cut off in favor of an innocent seller equities of the bank. On the one hand it may be argued that the seller, regardless of whether he has changed his position or not, is a donee of the bank's promise or else is sufficiently identified with the buyer to be affected in all cases by the latter's conduct.¹⁴ On the other hand it may be said that, regardless of whether the seller has changed his position or not, the whole transaction between seller and buyer, buyer and bank, and bank and seller should be treated as one transaction, and that, although the sales contract and the letter of credit are separate contracts, nevertheless the innocent seller, having given value in the same transaction, is not a donee, and is therefore in all cases to be preferred to the bank.¹⁵ It is submitted that the better solution is to make the question of whether the seller or the defrauded bank is to be preferred depend upon the seller's change of position in the particular case. The seller has received a legal obligation of the bank. The only question is whether it is conscientious for him to enforce a clear legal right. He is innocent, but he is a donee. If he has done nothing to change his position before the bank discovers the defense the bank should be permitted to avoid the obligation. But if the seller has changed his position in good faith it is not inequitable for him to enforce his legal right, and the bank should be precluded from setting up its defense.

IS APPRECIATION IN VALUE OF PROPERTY INCOME?—A taxpayer purchases property for \$10,000. The property rises in value to \$15,000. It is settled that so long as the taxpayer retains the property this increase in value cannot be taxed as income.¹ It is likewise settled that even if he does sell he cannot be taxed on that portion of the increase which accrued prior to March 1, 1913 (the effective date of the Sixteenth Amendment).² But the increment in value accruing after March 1,

the ordinary case. Certainly it might be disastrous to the buyer to be compelled to reimburse the bank and then bring an action at law against the seller.

¹⁴ *Green v. Turner*, 86 Fed. 837 (1898); *Clay v. Woodrum*, 45 Kan. 116, 25 Pac. 619 (1891); *Maxfield v. Schwartz*, 45 Minn. 150, 47 N. W. 448 (1890). See 1 WILLISTON, CONTRACTS, § 394. See also 3 WILLISTON, CONTRACTS, § 1518.

¹⁵ See *Price v. Neal*, 3 Burr. 1354 (1762). See also 1 HARV. L. REV. 1; 4 HARV. L. REV. 297.

¹ See *Eisner v. Macomber*, 40 Sup. Ct. Rep. 189, 193, 197 (1920).

² *Lynch v. Turrish*, 247 U. S. 221 (1918). But a dividend paid out of surplus accruing to a corporation before March 1, 1913, is taxable as income to the stockholder. *Lynch v. Hornby*, 247 U. S. 339 (1918).